ICE WORKING PAPER

ACCESS TO GLOBAL MARKETS TO SUSTAIN JOBS AND GROWTH

A FINANCIAL INFRASTRUCTURE PERSPECTIVE

DECEMBER 2016

1. EXECUTIVE SUMMARY

ICE believes that the agreement between the UK and EU on financial services should be based on the following principles:

- the agreement should ensure continuation of capital flows between the UK and the EU27. There is mutual reliance on financial services in both directions and frustrating access would damage the EU27's participation in global wholesale markets in London, and diminish the UK and the delivery of CMU;
- the UK should not have a right to special access to EU markets but at the same time should not be treated worse than other close partners of the EU27;
- it is in the interests of the EU to allow its companies access to global financial markets where this can be done without prohibitive cost or complexity; and
- after Brexit, the UK and EU should have in place a framework for future negotiations which enables the markets to continue to evolve and to agree equivalence based not on identical laws but on adherence to internationally agreed global standards.

POLICY OBJECTIVES

1. **An equivalence-based agreement.** European financial services law already enshrines the concept of equivalence, and this concept provides a sound basis for agreement between the UK and EU about financial services access. The EU concept of equivalence recognises that not all regulatory regimes are the same in every detail but that they seek the same kinds of outcomes. When the EU has determined that a third country regulatory regime is equivalent, firms based in that country can provide services to EU customers.
2. **No geographical restrictions on clearing location, reflecting the Euro's status as a globally traded and cleared reserve currency.** Mechanisms already exist to ensure robust information-sharing and to ensure cross border payments are managed effectively. Restrictions on the clearing of euro-denominated instruments would deprive European banks of access to liquid trading and clearing facilities and create fragmentation as they may also be prevented from accessing directly those non-EU facilities supported by global banks and infrastructure. This would increase costs considerably for banks and their customers. Estimates vary as to how much overall initial margin would increase if Euro clearing should move out of London, but a significant increase in these costs cannot be ruled out.
3. **Continued access to UK-hosted markets for EU's financial institutions and corporates, with the UK remaining focused on securing economic growth across the continent of Europe as well as domestically.** The UK has long had an exemption from the requirement for regulatory authorisation for third country financial market participants carrying out investment business with institutional clients or counterparties in the UK on a cross-border basis. The "overseas persons exclusion" applies to a broad range of sectors, including exchanges, clearing, settlement, brokerage, derivatives, agency business and advice.
4. **Better regulation.** Following the 2008 economic crisis, the EU introduced a wide-ranging set of new regulatory requirements. These implemented the G20 framework, but in some cases exceeded the global mandate and introduced regulation in regulated areas such as exchange traded instruments, which did not contribute to the crisis. Both the UK and EU should use Brexit as a catalyst to review existing and proposed regulation to ensure that it is consistent with the promotion of better regulation which protects customers, enhances effectiveness and fairness and adheres to internationally recognised global standards.
5. **UK and EU to work together to ensure enhanced global regulatory cooperation.** EU and UK regulators should establish an informal framework for regulatory dialogue as a prelude for a more formal information sharing and cooperation framework to follow Brexit. This would be a broader and deeper version of the Financial Markets Regulatory Dialogues which are already in place between the UK and US and the UK and Japan.

2. INTRODUCTION

2.1 BACKGROUND TO ICE

Intercontinental Exchange (ICE) was founded in 2000 with the backing of major power suppliers and their customers to provide an efficient trading platform for power. Clearing and data were quickly added and the following year ICE expanded into the UK with the addition of energy futures through the acquisition of the International Petroleum Exchange.

Today ICE is one of the world's largest diversified financial services infrastructure groups, with operations in Europe, the US and Asia including 11 exchanges, 6 clearing houses and data across 9 different asset classes. As owner of the NYSE, ICE is the listing and trading venue for companies with a combined market cap of over $25 trillion, and is also the provider of the world's leading energy, carbon emissions, soft commodities and European interest rate futures markets.

Since 2001, ICE has committed over $1bn of capital to the formation and growth of global markets based in the UK and Europe and is committed to ensuring that its engineers, strategists and problem-solvers continually create and improve technology that solves market structure challenges on behalf of its customers. Its extensive network of exchanges, clearing houses, data and technology services enables market participants around the world, including major European companies such as BP, Shell, Total, RWE and Tate & Lyle to manage risk and raise and invest capital.

ICE believes that London's role as a global financial centre, backed by first class regulation and underpinned by world leading technology, is of paramount importance to the future of the continent of Europe. This working paper seeks to outline the basis on which ICE believes the EU can ensure that it remains open to global markets hosted in the UK, open to the world and supports continued growth and job creation within Europe's real economy.

2.2 ACCESS TO MARKETS

The United Kingdom has a unique position as a financial centre located in Europe, which hosts many markets which are global in nature and whose customers are from all over the world. A central issue in the forthcoming negotiations between the UK and the other members of the European Union ("the EU27") will be the level of access to European markets which the EU27 are prepared to grant to UK businesses after the UK's departure from the Union. Of equal importance will be the UK's ability to continue to serve corporates, financial institutions and governments from Europe and around the world which access London-based deep, liquid markets to fund and protect jobs and growth. It is these "wholesale" markets" on which this Working Paper is focused. Separate considerations may apply to retail products.

Recent public statements suggest that the debate could become more and more polarised over coming months. The UK Government[1] has made clear that it is not prepared to agree to continue to allow freedom of movement in the way that it currently operates between the UK and the rest of the EU and European politicians have clearly stated that this means the UK cannot retain the same level of access to the EU28 single market that it currently enjoys. Some UK-based financial services companies have warned that if they are unable to retain the kind of access to EU markets which they currently enjoy, they will relocate their businesses. Far from an automatic relocation of UK-based financial services businesses and jobs to continental Europe there are other obvious, and just as likely, consequences – companies will scale back or close operations, and others will relocate operations to the USA.

Given the dichotomy described above, it is incumbent upon us all to seek practical, achievable

[1] The Prime Minister, Theresa May, speaking at Conservative Party Conference at The ICC, Birmingham on 5 October 2016: **http://press.conservatives.com**

solutions which operate in the interests of the European continent as a whole. It is important that both the UK Government and the European Union keep the wider regional jobs and growth agenda in mind during the Brexit negotiations. The EU27, with 445 million producers, consumers and citizens, will remain one of the key trading partners for the UK. As should the UK, with 65 million consumers, citizens and expertise in financial services, remain close to the EU27.

Financial services play a key role in supporting jobs and growth by providing the financing and risk management necessary in a modern, developed economy. Efficient and dynamic financial markets are needed for all participants. The financial services industry as a whole, but UK based financial services in particular, serve the wider economy and contribute to growth; via trade and infrastructure financing, risk-mitigation via hedging and ensured delivery via post-trade services such as clearing and settlement. The UK's financial services sector produces 12% of total UK economic output, contributes £66bn in taxes and employs over 2.2m people. Estimates show the value added to the economy per financial and related professional services worker is £87,000, compared to an average of £52,000 in other sectors[2].

The EU's Capital Markets Union project aims to unlock more investment in Europe both from the EU and the rest of the world and London is a crucial component to being able to deliver a CMU that can match the other regional capital raising centres. With the UK leaving the European Union, the UK-based financial services industry wants, and should continue, to provide diversified sources of funding for trade and investment to the EU27. The UK currently has undoubtedly the most advanced capital market in Europe, manifesting itself in the UK-trade surplus in the financial sector of £63.4bn in 2015, a surplus larger than the equivalent surplus of the next four biggest economies combined (USA, Switzerland, Luxembourg and Singapore)[3]. Therefore the EU and the UK should work towards a mutual beneficial agreement, which allows UK based financial industry to provide continued financing for the benefit for the whole European economy.

This paper sets out a proposed basis for an agreement between the UK and EU on financial services, based on the following principles:

- the agreement should ensure continuation of capital flows between the UK and the EU27. There is mutual reliance in financial services in both directions and frustrating access would damage the EU27's participation in global wholesale markets in London, and diminish the UK and the delivery of CMU;
- the UK should not have a right to special access to EU markets but at the same time should not be treated worse than other close partners of the EU27;
- it is in the interests of the EU to allow its companies access to global financial markets where this can be done without prohibitive cost or complexity; and
- after Brexit, the UK and EU should have in place a framework for future negotiations which enables the markets to continue to evolve and to agree equivalence based not on identical laws but on adherence to internationally agreed global standards.

[2] Key Facts about UK Financial and Related Professional Services 2016, TheCityUk, 2016:
https://www.thecityuk.com/research/key-facts-about-uk-financial-and-related-professional-services-2016

[3] Key facts about the UK as an international financial centre, TheCityUK, November 2016:
https://www.thecityuk.com/research/key-facts-about-the-uk-as-an-international-financial-centre-2016

3. A DEAL TO SUSTAIN JOBS AND GROWTH

In our view:

- The EU and the UK should agree mutual access to financial markets which builds on the principle of equivalence already enshrined in EU law, broadening it where to do so would be mutually beneficial.
- It is mutually beneficial for the EU to continue to be open to global business, and not use Brexit as a premise for retreating from international trade in financial services.
- The UK should continue to be open to EU companies and should make clear that it will place no restrictions on EU financial services companies being able to operate in the UK after Brexit as they do today.
- Both the EU and the UK should pursue a better regulation agenda conducting reviews of recent financial services legislation to look at the impact on firms in the 'real economy' and should look to remove those elements from UK regulation which have been specifically designed to regulate the EU27 internal market.
- The EU and UK should come together to help enhance global regulatory cooperation as a basis for agreements and standards to underpin mutual equivalence.

4. POLICY RECOMMENDATIONS

4.1 EQUIVALENCE AS THE BASIS FOR AN AGREEMENT

Banks, investment banks, fund managers and other financial institutions in the UK will need continued access to the EU financial markets in some form following the UK's exit from the EU. Similarly corporates of all kinds, including financial services firms, based in the EU will need to maintain access to global wholesale financial markets and the 65 million UK consumers of goods and services. Much of the recent debate in the UK has focused on the need for the retention of existing 'passporting' arrangements currently available to UK firms as the UK is part of the EU. Some have argued that the UK should remain a member of the European Economic Area and thereby retain the full EU passporting arrangements that its financial services firms enjoy today.

However, we do not believe this is likely to be achieved since the UK government has made clear that it is unwilling to accept the kind of freedom of movement that it would need to agree to as a condition for existing passporting arrangements to continue. And the UK's voters have made it clear that they would be unwilling to accept laws emanating from the EU27 without any representation or influence.

Instead, arrangements will need to be on the basis of third-country access, premised on determinations of "equivalence" by the EU. European financial services law already enshrines the concept of equivalence, and this concept provides a sound basis for agreement between the UK and EU about financial services access. The EU concept of equivalence recognises that not all regulatory regimes are the same in every detail but that they seek the same kinds of outcomes. When the EU has determined that a third country regulatory regime is equivalent, firms based in that country can provide services to EU customers.

Equivalence does not mean that regulatory regimes need to be the same. For example, the EU has determined a number of regulatory regimes as equivalent for the purposes of the European Market Infrastructure Regulation ("EMIR") including the US, Australia, Singapore, Japan, Hong Kong, Canada, Switzerland, South Africa, Mexico and South Korea. These regimes all follow relevant global standards but there are a number of differences in national rules in areas where global standards are silent, and their legal regimes differ substantially. For example the rules that apply to CCPs in - for instance - the US, the EU and Singapore - share common elements on which there is international agreement (e.g. the G20 obligations) but differ in innumerable aspects of detail when compared side-by-side. Crucially, it enables each sovereign country to determine what it is appropriate for its own economic well-being, whilst still providing a basis for global trade.

Equivalence has been incorporated in a number of elements of EU financial services legislation, including:

- the European Market Infrastructure Regulation ("EMIR") - which regulates CCPs;
- the Markets in Financial Instruments Directive ("MiFID II") - which governs the functioning of financial markets and the distribution of investment products;
- Solvency II - which codifies and harmonises EU insurance regulation;
- Benchmarks - which regulates the production of financial benchmarks;
- the Payment Services Directive - which provides the legal foundation for the creation of an EU-wide market for payments; and
- the Alternative Investment Fund Managers Directive (AIFMD) - which regulates hedge funds, private equity, real estate funds and other alternative investment fund managers in the EU.

Some in the UK have been critical of equivalence as a basis for agreement, since it relies on an ongoing assessment of the comparability of the regulatory regimes and could be withdrawn at short notice. However, the basis on which equivalence is determined is outcomes-based and informed by adherence to global standards. Recognising the global trade imperative, cooperation between regulators has so far provided a basis for identifying and resolving any difficulties which have arisen. It is overwhelmingly in the European public interest for the UK and EU to agree particular mechanisms around UK and EU equivalence determinations which help to ensure that any issues which arise are resolved through negotiation and that continuity of two-way access is assured.

So while there will need to be ongoing arrangements for cooperation between the UK and EU, in some cases the UK will be able to amend or adapt a more targeted regulatory regime without jeopardising its ability to be recognised as equivalent under relevant EU regimes. Any equivalence decisions by the UK and EU should not be based on a line by line comparison of the legal text, but outcome-based with a focus on internationally-agreed global standards.

GAPS IN THE EQUIVALENCE FRAMEWORK

Currently, not all EU regulations provide for a workable third country regime with equivalence determination; for instance for lending, deposit-taking, insurance mediation, UCITS funds, exchanges, primary insurance, payment services and some retail financial services.

Many of the regimes where it is absent pre-date the more recent introduction of equivalence and so represent a historical anomaly that can be addressed. In the absence of an equivalence regime, it is likely that the markets continue in the UK but establish distribution arrangements in the EU. This is likely to layer on unnecessary costs and make products less useful to industrial and commercial companies in the EU. Furthermore, it is clear that many European financial businesses will also require access to all types of UK financial services counterparties and customers. There is a mutuality of interest between the UK and EU in resolving this issue.

4.2 THE EURO: A CURRENCY FOR GLOBAL BUSINESS

According to press reports[4], some senior politicians and officials in Eurozone countries have suggested that the clearing of Euros should be restricted following Brexit so that it can only take place within a country which has adopted the Euro as its primary currency, therefore 19 of the 27 remaining EU Member States. Given that the Euro is the world's second largest reserve currency and as such provides significant benefits for Member States, the wider EU and companies trading overseas, any such protectionist move could severely damage confidence in the currency within the global economy.

Derivatives contracts are cleared globally - contracts denominated in Yen, Euro and Sterling are traded and cleared in the US; US Dollar, Korean Won and Sterling-denominated contracts are traded and cleared in Europe. For example, out of a total daily average for dollar-denominated clearing of $1.49t, $329.69b is cleared outside of the US and, for euro-denominated clearing, $595.32b out of a daily total of $762.49b occurs outside of the Eurozone[5].

Global CCPs manage the risk of these products by collecting margin in a range of collateral which might include cross-currency margin such that margin requirements for euro-denominated contracts are collateralised with US Dollars or UK gilts. It is important to distinguish between the trading and clearing of euro-denominated contracts and the settlement of Euro currency. Settlement of Euro-currency is separate to financial trade activity - such as derivatives - and arises as an ordinary function of commerce. For example a large settlement of Euros may be made by a commercial firm in payment for goods. To the extent the payment crosses international boundaries central banks maintain relationships to ensure the "global" payment system functions smoothly.

[4] See, for example "Francois Hollande rules out City's Euro Clearing Role" Financial Times, 29 June 2016.

[5] Triennial Central Bank Survey, Bank of International Settlements, Sept 2016: **http://www.bis.org/publ/rpfx16.htm**

Clearly, it is important for the safety and soundness of CCPs that they have access to liquidity arrangements in the currencies they clear. This liquidity can come either through commercial or Central Banks. However this does not mean that central clearing of euro-denominated derivative contracts outside the Eurozone should be prohibited and other mechanisms exist to ensure robust information-sharing between CCP supervisory authorities and more generally to ensure cross border payments are managed effectively.

Handling 75% of euro-denominated derivatives transactions at an average daily value of $573.64bn the UK is the largest centre for the clearing of Euro derivatives globally, and there is no reason why this should change as a result of Brexit. Through a forced (re)-patriation of euro-denominated instruments EU banks may be deprived of access to liquid trading and clearing facilities, and may be prevented from accessing directly those non-EU facilities supported by global banks and infrastructure. This would increase costs considerably for banks and their customers, including on initial margin, which estimates indicate would significantly increase if Euro clearing should move out of the EU. This is because the existing margin pool benefits from portfolio efficiencies that would be unavailable if the euro-denominated portion were disaggregated.

4.3 UK: OPEN TO EU BUSINESS

It is important that UK's openness to, and accessibility by, EU firms is not compromised by the UK's withdrawal from the EU. Firms that access the UK's wholesale markets remotely from the EU, or who only deal with or through firms which are authorised in the UK, should be able to continue to do so in a straightforward manner. In addition, it must also be ensured that those who have, or who are planning to establish, a physical presence in the UK do not face new barriers in terms of increased operating costs, the need for case-by-case approvals, or both.

A related issue requiring consideration is the future status of large branches of EU banks, which currently operate without the need for locally capitalised subsidiaries or local regulation, on the basis of aligned regulatory standards under European regulation and the EU passport. It is key to the success of UK financial markets that these EU institutions can continue to book and conduct business from their UK branches, in order to carry out business in a cost-effective way.

To avoid creating barriers to cross-border financial services, we propose that the UK Government streamlines the process for all foreign firms (both EU and non-EU) who access the wholesale markets based in the UK. The UK could add to the overseas persons exclusion by establishing an "equivalence" regime of its own for branches. This would comprise a list of overseas jurisdictions which meet international regulatory standards and which have regulatory information-sharing and cooperation agreements with UK authorities. This would allow any firm authorised and regulated in one of those jurisdictions to do business in the UK with eligible counterparties and professional customers from a branch office in the UK, subject to compliance with local UK branch regulatory and conduct requirements.

For its part, EU rules should allow UK firms that conform to the latest global standards to access EU markets on the same terms as they would if they were based in the EU, under an equivalence regime. These proposals would maintain and enhance the access arrangements which firms have to international wholesale markets hosted in the EU and UK, whilst maintaining high standards of financial regulation. Failure to achieve this basic outcome could result in the wholesale markets locating away from the UK and Europe to the benefit of other established financial centres such as New York or Singapore, which would neither be of benefit to the UK nor the European Union.

We recognise that wider political considerations might prevent access to UK wholesale markets being applied on a purely unilateral basis, in which case we would encourage the EU and UK to agree mutually-beneficial reciprocal arrangements.

4.4 BETTER REGULATION

Following the 2008 economic crisis, the EU introduced a wide-ranging set of new regulatory requirements. These implemented the G20 framework, but in some cases exceeded the global mandate and introduced regulation in regulated areas such as exchange traded instruments, which did not contribute to the crisis. The UK has a long history of regulating to a global standard, and it is imperative that this reputation for high standards of regulation does not diminish post-Brexit. A commitment to maintaining and where necessary enhancing the UK regulatory regime to ensure the safety of the financial system is therefore a minimum requirement.

EU and UK legislators have acknowledged that the cumulative impact of the post-crisis regulation was unknowable until after the rules are fully applied. The European Commission launched the Call for Evidence process in the context of the Capital Markets Union, to reassess and readjust financial services regulation in the EU. Evidence is now arising of the negative effects of regulations that have gone too far. When implemented they will lead to a reduction in the effectiveness of financial markets in providing funding and helping to manage risks and growth in the real economy.

The burden on the financial services industry in the UK is particularly acute, since the UK hosts a number of global markets, some of which compete with financial centres which have developed more precisely targeted regulatory approaches in line with global standards.

Both the UK and EU should use Brexit as a catalyst to review existing and proposed regulation to ensure that it is consistent with the promotion of better regulation which protects customers, enhances effectiveness and fairness and adheres to internationally recognised global standards. There are a number of specific rules within the forthcoming MiFID II directive which go beyond internationally recognised global standards without any concurrent improvement to customers, fairness or effectiveness.

Examples of poorly targeted EU regulation include:

- The EU is the only major regulatory regime to require the reporting of exchange-traded derivatives to trade repositories. This is an expensive and complicated process which increases the number of derivatives subject to reporting by an order of magnitude. It places a financial and administrative burden on many end-users of derivatives with no corresponding regulatory benefit. In other jurisdictions clearing of those transactions is considered sufficient reporting.
- The EU regime on position limits, which has still not finally been agreed, imposes position limits on hundreds of futures contracts, most of which are operated in the UK and few of which have a price discovery function. The equivalent US regulation will apply only to 26 of the most significant contracts. This will make it much more difficult for financial markets to intermediate and provide risk management to real economy companies wishing to hedge risk, and increase the cost of hedging for those companies, without improving price formation or market efficiency.
- New EU market structure rules go beyond global requirements and extend mandatory access from OTC derivative markets to exchange-traded derivatives. This will impose cost and complexity on a part of the financial infrastructure which worked well throughout the financial crisis, and deter international infrastructure providers from basing new business in the EU.

The EU and the UK must operate clean, fair and resilient markets that adhere to global standards of integrity. These are fundamental pre-conditions of their ability to continue to attract high levels of participation from businesses and individuals around the globe. These tenets are also consistent with agreed international standards which have been implemented within the G20 framework, by the Financial Stability Board, the Basel Committee on Banking Supervision and CPMI/IOSCO with significant involvement by UK authorities. All regulatory systems must fully reflect those global standards and best practices. Both the EU and the UK should take advantage of the opportunity which Brexit presents for the streamlining of regulatory requirements in the EU and UK, and to advance a better regulatory agenda based on adherence to these global standards.

The EU and the UK should continue to work closely together post-Brexit, but it would not be appropriate for the UK to have a say in the legislative process around the EU's financial services rules, and nor would it be appropriate for the EU to have a say in the UK process. However, a structured open dialogue between the UK and its Financial Authorities and the European Union should be put in place to ensure close regulatory cooperation and supervision in the region.

4.5 GLOBAL REGULATORY COOPERATION

EU member states and the UK participate in many international fora, including the G20, the Financial Stability Board, the Basel Committee on Banking Supervision and CPMI/IOSCO.
The UK and EU should pursue a set of core objectives based on:

- delivering regulation which targets genuine risks faced by markets and investors;
- achieving effectiveness and proportionality in the design and application of regulatory provisions; and
- avoiding disproportionate regulations which add cost and complexity without providing meaningful market or investor protections.

This should be guided by the following ethos:

- it is right for international policy makers to require appropriate standards of safety and prudence in the way in which business is conducted;
- it is also right for national regulators to prohibit and take actions against abuses which can result in financial loss and damage to market confidence;
- however, it would be wrong for international bodies or regulators to design the shape and structure of the industry itself. That could put a straightjacket on market-driven solutions which would only serve to stifle innovation, competitiveness and choice.

4.6 A FRAMEWORK FOR AGREEMENT

Market participants need clarity and certainty. Extended uncertainty in the pursuit of negotiating objectives which are unlikely to be achieved is not in the interests of the industrial and commercial companies who depend on Europe's wholesale financial markets.

In our view, therefore, there is a strong case for the UK and EU to move rapidly to agree the following:

- EU access for UK-based firms after Brexit will be granted on the basis of third country equivalence. As part of this process, the UK and EU will agree particular mechanisms around UK and EU equivalence determinations which help to ensure that any issues which arise as a result of evolving laws and regulations are resolved through negotiation.
- Given agreement on that approach, UK and EU regulators will begin working on initial equivalence applications and determination as soon as the UK triggers Article 50, with a view to equivalence being confirmed in advance of the UK's departure from the EU.
- Where such third country equivalence provisions are not available but are desirable - notably with respect to CRD IV - a transitional period will be established to allow UK firms to operate on the existing basis while such equivalence provisions are agreed by the EU.
- Subject to the above, the UK should adopt an open approach for EU27-based firms which currently benefit from the MiFID passport, allowing them to continue to operate in the UK to provide those categories of business where the EU allows third country equivalence or where the extension of third country equivalence provisions has been agreed in principle.
- EU and UK regulators should establish an informal framework for regulatory dialogue as a prelude for a more formal information sharing and cooperation framework to follow Brexit. This would be a broader and deeper version of the Financial Markets Regulatory Dialogues which are already in place with the US and Japan.

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